THEME: COMMINGLING ITEMS

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ACCOUNTING TERM: Commingle

In a business context, commingle means to mix together business and personal items such as assets, cash, expenses, etc.

FEATURE ARTICLE: Commingling Business & Personal Items

Commingling of various types of business and personal items usually occurs when someone is first starting out in business. Things haven't really gotten off the ground yet so the personal checkbook is still being used for business purchases. Or, if a business account is set up it seems too inconvenient to have to write checks out of two separate accounts.

In either case, unless the owner understands enough about accounting, the books can become a real mess. This is especially true when the owner records both business and personal items into a computerized accounting system such as QuickBooks. Car payments get recorded to Auto Expense even though no Notes Payable for the car was ever set up as a liability. Nor, was a Fixed Asset for the original auto purchase recorded. The principal and interest for the auto note end up recorded into Auto Expense along with gas, maintenance, and insurance costs. Home mortgage payments, both principal and interest, get posted to Rent expense. Home property taxes are recorded into Taxes, License & Permits. Personal utilities such as water, garbage, electric, and gas are all lumped into the Utilities account. Money received from a personal loan is sometimes recorded as income. These examples are a gross form of commingling and occur when someone really has no concept of how a business financial statement is prepared.

More common forms of commingling occur when the owner buys food for personal use and picks up some batteries for business purposes. Or, when a personal credit card is used to purchase business expenses or vice versa. Another example is when a business vehicle is used for personal purposes. A more subtle form of commingling is when the owner uses business products for personal use. This often occurs in multi-level marketing businesses where the owner is required to buy inventory but then uses part of it personally.

It's not hard to imagine how impossible it is to determine what the true net profit or loss might be in a business that commingles business and personal items. Or, to determine what the equity is in a business whose assets and liabilities include personal items.

You may have done this sort of thing in the past but then discovered the error of your ways and now maintain a separate checking account for personal and business purposes. However, it might be a surprise to know how many folks still mix the two items together. For those that do, read on, hope is on the way.

QUESTION: What Problems Result From Commingling?

First, financial statements prepared from a computerized accounting system that contains commingle items it will make no sense. In fact, it is useless. Maybe even worse than useless because it will take extra work to try and ferret out the true business items from the personal ones. This is known as a "pain in the behind", to put it diplomatically. It is not unlike having to untangle a knotted up ball of string. Even though an accountant/tax person gets paid by the hour, he/she would probably prefer not to have deal with it.

More important, is that the Internal Revenue Service (IRS) (for U.S. citizens) frowns on commingling. If they suspect that is what's happening then make plans for an audit.

The IRS is focused on things like personal use of autos, computers, phones, lunches, travel or any items that can easily be used for personal reasons. That is why you cannot deduct expenses for clothes you wear to work. It seems like a business expense but since you "could" wear the clothes for non-business purposes it is not allowed. Only clothing such as a uniform or cork boots that would not be worn for personal use is allowed. The IRS has developed formulas for determining what percentage of business use occurred and require documentation to prove business use before a deduction is allowed.

The IRS isn't the only agency concerned about business vs. personal use. If you live in a state that has a sales tax there will be a regulatory agency that governs that activity. In California it is called the State Board of Equalization (SBOE). Normally, they issue a license to buy product at wholesale prices because the intent is to sell the product, collect sales tax and pay the agency. However, if the product was used personally then you can get into trouble. This is why the SBOE conducts random audits of businesses.

Remember, that ignorance is no excuse for breaking the law. The agency doesn't care if no one told you about the law. They don't care if you are just starting out in business. Hopefully, you are not naïve enough to believe that what they don't know won't hurt them. That is a dangerous attitude because if they do catch up with you, their opinion will be that you participated in a criminal activity just like any other thief who steals money. Period!

TIP: Keeping Commingled Items Separate

It is probably inevitable that there will be some occasions when personal money is used for business purposes and vice versa. It is not a problem if handled correctly. Here are some examples of how to record commingled transactions:

- **Out of pocket expenses** – This is the common situation when you pay for business items out of personal funds. Keep track of your receipts and do one of two things. (1) Write a business check to yourself for the amount of the receipts and code it to the appropriate expense accounts. (2) Write a general journal entry with a debit going to the expense accounts and the credit to Owner's Draw (if a sole proprietorship).

- **Credit card purchases** – If you have a business credit card and some personal items are on it simply code the personal items to Owner's Draw when coding all the charges on the card for the month. If you used a personal credit card and have some business expenses, make a copy of the statement, circle the business items and reimburse yourself or write a journal entry as explained above.

- **Personal auto use** – For tax purposes, you are supposed to keep track of your business miles driven. Subtract that number from the total miles driven and you have your personal miles. Multiply the personal miles times a rate (use the IRS rates) to determine the dollar amount of personal use. All of the costs for driving the auto have been going into Auto Expense so you need to remove the personal amount from that account. Do that by writing a journal entry with a debit to Owner's Draw and a credit to Auto Expense.

A person could use the same checking account for both business and personal items, **IF**, they know enough about accounting to keep the items separate within the company books. For that to happen, all the personal items need to be recorded to the Owner's Draw account. This requires a careful assessment of the nature of each transaction and good accounting technique. Seems like a hassle to me.

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